



09/16

MEMORANDUM FOR ASSISTANT REGIONAL ADMINISTRATORS

FROM: *William H. Matthews*
WILLIAM H. MATTHEWS
ASSISTANT COMMISSIONER - PV

SUBJECT: Pricing Policy Modification #13
Application of the Tenant Improvement Allowances

The attached pricing policy modification addresses application of the tenant improvement allowances. The policy modification was initiated based on regional request to clarify the methods available to set the tenant improvement allowances and to incorporate the revised OMB Circular A-11, Appendix B rule that requires special features or enhancements unique to the Government be funded up-front by the Customer Agency rather than financed through the lease.

The policy modification was drafted in coordination with the Regional Pricing Points of Contact (POC's) and the Pricing Network. A copy of this policy modification is being provided to the Regional Pricing POC's for dissemination within each Region.

If you have questions regarding this policy modification, please contact the National Pricing Points of Contact, Kevin Rothmier at 816-926-1100 or Steve Peters at 215-446-4670.

Attachment

cc: Assistant Commissioners, Regional PT Directors, Regional Pricing POCs



PBS Pricing Network

Purpose: Policy Modification #13 on Application of Tenant Improvement Allowances. Delete Desk Guide Sections 2.3.3 and 2.3.5 in their entirety. Replace with the following policy modification. The policy modification incorporates and replaces pricing policy clarification #9 on Office Hoteling Leases.

Effective Date: August 16, 2004

2.3.3 Application of the Tenant Improvement Allowances

For new occupancies, either leased or federally owned, PBS will arrange to amortize in Rent (subject to availability of funds in federally owned space) the tenant improvement allowance. The section below on "Changing or Appealing an Agency Customization Tier" discusses how and when the allowance may be modified to provide functional space. The section below on "Application of OMB Circular A-11, Appendix B" discusses the limits on tenant-specific security-related tenant improvements that may be amortized in leased space for law enforcement agencies.

The tenant elects how the space is to be finished and thus controls the costs of the build-out. If less than the allowance limit is used, the resulting periodic payment will be lower. While the tenant allowance is comprised of two components, PBS makes the sum of the two components available for any build-out expense. PBS does not monitor the use of the allowances to ensure that the general component is used only for office-type finishes and the customization component only for specialty work. The dollar sum of the two components represents a funding source for whatever build-out the customer agency elects, as long as the space is finished, functional, and compliant with all applicable building codes.

The tenant allowance (general and customization components) can only be used to pay for items that are real property, or which become real property when attached or affixed to the building. The tenant allowance is not available to fund personal property, such as furniture and artwork, personal computers, phone handsets, or physical relocation expenses of personal property. PBS lacks the authority to use budget activities that fund the tenant improvement allowances for personal property purchases.

Temporary "Office Hoteling" leases are the exception to the above stated criteria. "Office Hoteling" space is leased "as is"; therefore, a tenant improvement allowance is not provided. Furniture, artwork, phone equipment and personal computers provided by the Lessor in temporary "Office Hoteling" type leases are not considered personal property. It is customary for this type of space to include these amenities. Temporary

"Office Hoteling" leases may not exceed 18 months. The furniture, artwork, phone equipment and personal computers will remain with the property when the lease terminates. In addition, it is customary for phone service and Internet access to be provided by the Lessor in "Office Hoteling" space. The "Office Hoteling" amenities may be included as part of base shell rent or operating rent in a temporary "Office Hoteling" lease according to the standard practice of the "Office Hoteling" vendor.

In the case of continuing occupancy, whether in owned or leased space, where PBS or the lessor provides a tenant improvement allowance, all soft costs (space planning, design, and construction management) as well as hard costs (labor, materials, general conditions, overhead, and profit for the general contractor and subcontractors) are charged against the tenant allowances. In the case of initial occupancy, whether in owned or leased space, space planning services through design development and services provided by construction management firms hired for design development review are not to be applied to the allowances. These services are provided by PBS as part of the PBS fee. Design from construction documents forward is charged against the tenant allowances. (See 3.2.10 PBS Fee, Space Planning for further information.)

Tenant-driven enhancements to the building shell are, by definition, tenant improvements; they are not shell elements. If a tenant wants to enhance the building shell, such as upgrading the HVAC, adding an elevator, increasing floor loads, or using specialty lighting in tenant areas instead of the building standard fixtures, these costs are chargeable to the tenant's allowance. Using the tenant allowance to enhance or modify building shell is not a violation of the "fire wall" discussed previously.

The following summarizes specific application of the TI allowance to each space type:

- Initial Occupancies – Full TI set in accordance with Section 2.3.3
- Continuing Federal Occupancies – As indicated in Section 4.2 Continuing Occupancies, Tenant Improvements During Continuing Occupancies, page 4-3, *Customer agencies may expect PBS to fund and amortize minor alterations and/or carpet and paint at the beginning of a new OA term, provided funds are available within the BA 54 budget.*
- Mid Occupancy Request for TI – PBS is under no obligation to provide a customer agency a TI allowance at any time during the occupancy term outlined in their OA. Pending funds availability and with the approval of the Regional Portfolio Director, PBS may fully or partially fund and amortize an agency request for tenant improvements.

Changing or Appealing an Agency Customization Tier

Given that PBS assigned each customer agency, at the bureau level, to a specific customization tier on the basis on an entire bureau's space holdings with PBS (blended together office with other types of usage) it stands to reason that for a new, predominately special purpose use, a bureau's customization tier may not be adequate to provide functional build-out. By the same token, for a new, predominately office space use, the general and customization allowances may provide more funding than the agency needs to fit-out the office space. PBS accepts that since the allowance tiers were designed to fund an average blend of space types (average for each bureau) from time to time individual requirements will arise for which the assigned customization tier is inadequate. Regional Asset Managers have the authority, on a case-by-case basis, to raise the tier or otherwise increase the tenant improvement allowance when the unusual build-out needs of a proposed occupancy so warrant.

PBS policy is not to employ the general and customization allowances for projects in which PBS has done both 1) extensive development of a space program of requirements (POR) for the tenant (s); and, 2) cost estimating, (using established national benchmarks or other measures, that determine the value of functional tenant space based upon that POR). For these projects, the tenant allowance is to be set in accordance with the benchmarks or cost estimates. For instance, in the case of a new courthouse, PBS relies upon a benchmarking process to estimate the dollars needed to design and construct not only the building shell, but also the tenant spaces. So, for example, instead of assigning the Administrative Office of the U.S. Courts (and other federal tenants) to a tenant allowance consisting of the general plus their assigned customization tier, it is appropriate to set the tenant allowance as the value of the benchmarks. This is also applicable when a particular block of space is not typical for a tenant and additional build-out is required to meet the functional needs of that space type. For example, a renovation and alteration project which involves a courtroom or cellblock only. In the case of non-prospectus projects, an extensive development of space program requirements or benchmarks are typically not available. PBS should, however, provide the customer with functional space that meets their operational needs, based on our cost estimates to do so. This still entails giving the customer agency a monetary allowance so that the customer can make choices between build-out elements, as long as the space is finished, functional and compliant with all applicable building codes.

For any specific space action, whether PBS contemplates a revision to a tenant allowance in accordance with benchmarks or a cost estimate to deliver functional space, or as a consequence of an agency request, the standard for determining the tenant allowance is not the total cost of tenant improvements. Rather, the standard is to ensure that the revised allowance covers the cost of basic functionality (operational requirements) for whatever the specific space use is. There is a distinction to be made between functionality and finish, fixture and feature enhancement. PBS is not obligated to ensure that all aspects of an agency's design guide or design guidelines are incorporated into their allowance, whether derived from a tier or POR/benchmark/estimating process. An agency's design guide typically provides for a wide degree of latitude in the selection

(and value) of finishes and fixtures for tenant space. PBS does not accept design guides as a substitute for the benchmarking process or the judgment of asset managers in setting allowance levels.

If a client agency believes categorically that the customization tier to which they have been assigned is inadequate to meet their fit-out needs, they may appeal their tier level assignment to the National Office of Real Property Asset Management. Tier level appeals must demonstrate through an analysis of several occupancies, that the agency's or bureau's tier allowance is consistently and materially less than what is required to provide functional space. An appeal of an agency's tier level assignment is not a Rent appeal and does not follow the Rent appeal process.

Application of OMB Circular A-11, Appendix B to Specific Space Actions

The recent changes (2003) to the OMB Circular A-11, Appendix B introduces the requirement to apply a specific set of rules and/or processes to each space or project type (i.e. leased, owned, prospectus and below prospectus) as it relates to the value of features and enhancements that are built or added for the Government's unique needs or special purposes. Each space type and its specifics are outlined below.

1. Prospectus – Leased

- The tenant allowance is to be set in accordance with the benchmarks or cost estimates to provide functional space.
- Total full service Rent cannot exceed the high-end market rent. High-end market rent is determined at the Regional level through a review of comparable leases in the vicinity of the proposed lease and/or review of published market data. OMB must concur with the Region's determination.
- Security-related tenant build-out unique to an agency such as holding cells, sallyports and special shielding to prevent electronic eavesdropping, which if financed through the lease would result in a rental rate beyond market, must be funded lump sum via RWA. Additionally, if the cost of these items can be financed through the lease and remain under the high-end of the market cap, OMB reserves the right to review and determine if these items are considered unique to the Government's needs or special purposes. If OMB determines the items are unique to the Government's needs or special purposes lump sum funding will be required from the customer.
- Building Specific Security countermeasures proposed to meet Interagency Security Committee (ISC) Design Criteria need not, categorically, be funded lump sum. However, if the OMB approved rental rate is not adequate to cover the cost of desired Building Specific Amortized Capital Security countermeasure(s), the countermeasure(s) must be funded lump sum.

2. Non-Prospectus – Leased

- The tenant allowance is to be set in accordance with the agency's tier or set based on a cost estimate to provide functional space.
- Total full service Rent, excluding Building Specific Security countermeasures proposed to meet Interagency Security Committee (ISC) Design Criteria cannot exceed the high-end market rent. High-end market rent is determined at the Regional level through a review of comparable leases in the vicinity of the proposed lease and/or review of published market data. Documentation must be included in the lease file.
- Building Specific Security countermeasures proposed to meet ISC Design Criteria need not be funded lump sum. They can be funded through the leases as long as their inclusion does not push the total rent over the prospectus dollar limitation. The countermeasures must be clearly separated from the shell and TI. These items are billed as Building Specific Security – Amortized Capital.
- Security-related tenant build-out unique to an agency such as holding cells, sallyports and special shielding to prevent electronic eavesdropping, may be funded through rent as long as their inclusion does not result in a rental rate that exceeds the high-end of the market. In those cases where their inclusion pushes the rental rate beyond the high-end of the market they must be funded lump sum via RWA. The amount of lump sum reimbursement is the dollar value of the tenant improvements that, if amortized, would push rent over the high-end market barrier. PBS will give agencies adequate time to budget for reimbursable expenditures for on going lease procurements. Therefore, this requirement will be implemented no later than 10/1/2006.
- Note: An agency may not pay lump sum for shell and first generation general tenant allowance elements (Chapter 6: Customer Rights and Options, Agency Lump Sum Options for Tenant Improvements and Rent). Concurrently, if a cost estimate is used to determine the allowance, PBS must deliver basic functional space without agency lump sum payments. If basic functional space cannot be delivered below the prospectus dollar limitation - prospectus authority must be sought.

3. Prospectus – Owned

- The tenant allowance is to be set in accordance with the benchmarks or cost estimates to provide functional space.
- The benchmark or cost estimate must include tenant specific security-related build-out, such as holding cells, sallyports and special shielding to prevent electronic eavesdropping, necessary for the tenant to function. The tenant's rent may exceed high-end market rent providing the improvements are within the functional standard for the agency.

4. Non-Prospectus – Owned

- The tenant allowance is to be set in accordance with the agency's tier or set based on a cost estimate to provide functional space. The tenant should be accorded (within PBS's ability to fund) the full complement of tenant allowances at initial occupancy.
- The tenant allowance should include tenant specific security-related build-out, such as holding cells, sallyports and special shielding to prevent electronic eavesdropping, necessary for the tenant to function. The tenant's rent may exceed high-end market rent providing the improvements are within the functional standard for the agency.
- Note: An agency may not pay lump sum for shell and first generation general tenant allowance elements (Chapter 6: Customer Rights and Options, Agency Lump Sum Options for Tenant Improvements and Rent). Concurrently, if a cost estimate is used to determine the allowance, PBS must deliver basic functional space without agency lump sum payments. If basic functional space cannot be delivered below the prospectus dollar limitation - prospectus authority must be sought.